

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Petition of Boston Edison Company,)
Cambridge Electric Light Company and)
Commonwealth Electric Company,)
d/b/a/ NSTAR Electric, for Approval of)
Revised Tariffs M.D.T.E. Nos. 100A, 101A,)
200A, 201A, 300A and 301A Relating to the)
Terms and Conditions for Distribution)
Services and Competitive Suppliers.)

DTE 05-84

REPLY COMMENTS OF DIRECT ENERGY SERVICES LLC

At the technical conference on this matter, which was held immediately after the public hearing on December 19, 2005, Staff expressed a strong desire for the commenting parties to propose options other than either granting or denying outright NSTAR's request to limit customer choice as a purported cure for an alleged "gaming" problem. At the technical conference and in their written comments, the parties did just that, identifying a number of reasonable alternatives to NSTAR's proposal, which would take the unprecedented step of limiting customer choice and forcing all customers, but especially those large customers who have been the greatest success story in restructuring, to stay on default service longer than they otherwise might.

Before discussing those choices in more detail, however, it is important to recognize the strong policy reasons, expressed by most parties, for proceeding with great caution before imposing a fundamental change in the rules that govern customer shopping in Massachusetts. There is broad consensus among the parties that the competitive market is working well for large C&I customers. In the Boston Edison service territory, for example, about half of the customers representing about 60% of the load are on competitive supply. The percentage of load on competitive supply is even higher in the Commonwealth and Cambridge Electric service

territories. Most parties agreed that for this customer segment, default service is working as it should, serving as a short-term alternative to competitive supply for a minority of customers, while the majority are served most of the time by competitive marketers.

Several parties added the key point that this customer segment has incorporated default service into its power purchasing decisions—a point which some parties may not have noted, and which should be of considerable importance to the Department. Radically changing the role of default service for this customer segment in the manner contemplated by NSTAR invites a potentially disastrous manifestation of the law of unintended consequences. DOER expressed this idea well in its written comments:

Besides not resolving the problem at hand, the NSTAR approach may have negative impacts on customers. First, by its very nature, the NSTAR proposal seeks to influence long-term business relationships among customers and their competitive suppliers by prohibiting customers from returning to their existing supplier. Second, the NSTAR proposal removes an important option for suppliers by disallowing movement of customers to basic service. Presumably, such an option allows these competitive suppliers to provide more competitive and lower prices to their customers. Removing this option may have the impact of increasing prices to customers who are currently taking competitive supply. Whether this price increase offsets the anticipated price decrease from NSTAR's action is difficult to determine, but there could be movement away from competitive supply back to basic service. Finally, NSTAR's proposal may motivate shorter-term contracts or cause competitive suppliers to add additional premiums to longer term contracts. In turn, shorter term contracts at retail can translate to shorter-term contracts at the wholesale level, which has been mentioned as a major impediment to financing new generation.

DOER Comments at 6. *See also* Retail Energy Supply Association (“RESA”) Comments at 12-13; TransCanada Power Marketing Comments at 2-3; The Energy Consortium Comments at 1 (Default service provides large customers and their suppliers with flexibility that results in lower prices).

In other words, the downside of precipitous action in this docket could be the destruction of the one aspect of the competitive market that actually works. That would be an ironic and tragic result for the one area where the Department can point to success in restructuring.

A departure from the Department's cautious approach towards restructuring over the years would be justified in this case only by clear and convincing evidence of significant harm to another customer segment that could not be mitigated in any other manner. However, there was broad consensus among the commenting parties that the NSTAR proposal does not come close to meeting this standard. Many parties noted that NSTAR has not demonstrated a relationship between the alleged "gaming" behavior (if it even exists) and any harm to other customers, nor has NSTAR attempted to quantify any such alleged harm. RESA Comments at 6-10; DOER Comments at 3-5; Cape Light Compact Comments at 2. It is difficult to imagine the alleged harm that would justify taking action that would result in large C&I customers facing higher prices and fewer choices but whatever that harm might be, NSTAR has not shown that it exists in this instance.

Moreover, a number of parties identified far more conservative approaches to the issue raised by NSTAR. These options give the Department an expansive "middle ground" in which to take action that would address NSTAR's alleged concern while preserving the robust competitive market that has developed for large C&I customers. These options include:

1. Defer action until the next default service procurement, pending further Department investigation, and subject to demonstration of a true emergency. NSTAR has attempted to portray this issue as an emergency, making its filing on November 21 and seeking a ruling by January 11. In fact, there is no emergency in evidence, and the Department should proceed with caution rather than haste. In its filing, NSTAR states that it studied customer

switching patterns in a *two-year period*, and its statistical conclusions are based on that period. Daly testimony at 7. Having taken two years to identify and raise this alleged problem, NSTAR makes no convincing argument for the sudden need to take immediate action rather than having the Department itself investigate the alleged behavior over the course of the next several months, which in any event, would be far quicker than the two years NSTAR took to conduct its initial investigation. Moreover, the NSTAR filing ignores some very good reasons (in addition to those discussed above) not to take immediate action. The last NSTAR procurement came at a time of unprecedented volatility in the energy markets. Two major hurricanes had disrupted Gulf Coast supplies of natural gas. The Middle East continued to experience a high level of unrest and uncertainty. Predictions of a colder than average winter caused natural gas prices to skyrocket. In such an environment, it would be impossible for the Department or any party to dissect the results of the RFP in terms of wholesale supplier behavior or resulting prices and identify some increment of price that is attributable to “gaming” as alleged by NSTAR, as distinct from price movements which are far more likely attributable to other factors.

The next procurement will be a key data point in determining what portion of the current default service prices may have been the result of major but transient events, so it is important that at a minimum, parties *examine* the next procurement period *without* any switching restrictions in place, in order to provide the proper comparison to the recent quarter, which contained major market impacts from hurricane activity and other unusual events. Only in this way can parties derive any better sense of what pricing activity is due to acts of God or other events.

Additionally, NSTAR has provided no evidence that the risk of proceeding with caution outweighs the benefits that would be gained from such an approach. Moreover, the more

cautious and prudent course of action, recommended by the preponderance of parties in this docket, would allow the Department itself to conduct an investigation of the various factors involved rather than relying on the sparse data provided by NSTAR. Even if NSTAR provides additional information in its reply comments, the Department will have only two weeks to consider that evidence before NSTAR claims it will need a response in order to incorporate any changes in its RFP. There is almost no certain downside to further investigation, and a great deal of near-certain downside to acting in haste.

2. Implement rational changes in the RFP process. Several parties identified changes in customer class designation for the RFP process that would almost certainly address any problem of the kind that NSTAR describes, and no party has produced any evidence to the contrary. RESA Comments at 18-19; TransCanada at 5-7. These options include: (1) redesigning customer classes so that supply for the largest customers is procured separately from supply for medium and small C&I customers; (2) fixed-block procurement, which would insulate wholesale suppliers from volatility caused by customer migration; and (3) elimination of the fixed price default service option for large customers. Any of these options could be implemented quickly, would reduce or eliminate the alleged impact on smaller customers discussed by NSTAR, and would be unlikely to have a negative impact on the robustness and efficiency of the competitive market for large customers.¹

¹ The only objection raised to any of these options at the technical conference was Staff's concern that a large customer-only procurement would result in higher prices for large customers who are unable to shop due to poor credit. In response to this concern, Direct Energy agrees with the comments of other marketers that the competitive market has become adept at serving such customers, using various means of financial security or prepayment. Further, to the extent this proves to be a continuing concern, Direct Energy encourages the Department to consider a permanent solution to the credit issue in the form of a purchase of receivables program, as discussed in both the technical conference and written comments in DTE 04-115. Utility purchase of supplier receivables makes suppliers indifferent to a customer's credit rating, increasing competitive options for all customers.

3. Tie any action to an immediate investigation of hourly pricing for large customers.

Nearly every commenting party agreed with Direct Energy's position that the most effective and permanent cure for any alleged problem identified by NSTAR is the implementation of hourly pricing (also referred to as "real-time" or "LMP" pricing) for large C&I customers. RESA Comments at 14-17; DOER Comments at 6-7; TransCanada Comments at 6. DOER also echoed Staff's comments at the technical conference that the recently enacted Federal Energy Policy Act of 2005 creates an opportunity in this area, as it "directs states to conduct an investigation and issue a decision on whether or not it is appropriate for their state to move to time-based pricing and other demand response programs. See, Subtitle E: Amendments to PURPA, Section 1252." DOER Comments at 8. Moreover, not only would hourly pricing eliminate the alleged "gaming" discussed by NSTAR, it would bring other important benefits in terms of demand response and customer control over electricity usage. DOER Comments at 8; RESA Comments at 15-16.

At the technical conference, NSTAR declined to take a position in support of hourly pricing, though neither did NSTAR oppose hourly pricing. NSTAR simply indicated that they would welcome an investigation of hourly pricing. Direct applauds NSTAR for supporting such an investigation.

However, NSTAR's position appeared to be that there were technical impediments to the implementation of hourly pricing in the near-term and so it preferred not to discuss hourly pricing in this docket, which is disappointing to Direct Energy, and we presume similarly disappointing to the many other commenting parties in this docket who have raised a chorus of support for hourly pricing as the most elegant way to solve any load volatility problems, as has been successfully done in other jurisdictions. *See, e.g.*, RESA Comments at 17; DOER Comments at 6-7. It would be extraordinarily short-sighted, however, to ignore a measure that

would improve retail and wholesale markets while considering options that could seriously erode the positive aspects of the competitive market as it exists in Massachusetts today. As DOER put it,

The question posed by NStar's filing is timely in the sense that it shows the need for the Department to move quickly forward on their investigation in the context of real market activity. At a time when momentum appears to be building to implement RTP for a myriad of other worthy policy reasons, it makes no sense to impose a rule change that will hamper rather than enhance the control large customers have over their electricity bills. We urge the Department to not be side tracked by a short-sighted and potentially harmful solution to broader pricing issues and seize the moment to show leadership toward a more effective and real solution.

DOER Comments at 7-8.

Direct Energy agrees completely with these sentiments. If the Department is inclined to take any action in the short-term, that action should only be taken in conjunction with the immediate commencement of an investigation into hourly pricing for larger customers. Further, any near-term change in market rules for larger customers should be temporary, to be replaced by some form of hourly pricing at the earliest possible time. There is a wealth of information from other states regarding the implementation of such pricing. Direct Energy believes that once an investigation is begun, this information can be used to quickly and efficiently address the concerns expressed somewhat vaguely by NSTAR at the technical conference. Ignoring hourly pricing, however, while adopting any restriction on customer choice would send exactly the wrong message to market participants, namely that the Department is willing to sacrifice the long-term health of the market in favor of short-term solutions to a problem *that may not even exist*.

The "middle ground" sought by Staff at the technical conference thus is clear. If NSTAR provides the Department with solid evidence that the alleged practice (a) actually exists; (b) has a

negative impact on wholesale supplier response to default service RFPs; (c) results in actual higher prices for a customer segment that does not have competitive options; and (d) could be remedied by a measure that will not do more harm than the problem it is meant to cure, then, *and only then*, should the Department feel constrained to take some action at this time. Any such action, however, should only be along the lines of those less intrusive options discussed above, and should be accompanied by the immediate commencement of an investigation into hourly pricing for large C&I customers.

Respectfully submitted,

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